

**OTTAWA COUNTY RURAL WATER DISTRICT NO. 2
SALINA, KANSAS**

**FINANCIAL STATEMENTS WITH
INDEPENDENT AUDITORS' REPORT**

For the Years Ended December 31, 2011, and 2010

**OTTAWA COUNTY RURAL WATER DISTRICT NO. 2
SALINA, KANSAS**

TABLE OF CONTENTS

	<u>Page Number</u>
INDEPENDENT AUDITORS' REPORT	1
MANAGEMENT'S DISCUSSION AND ANALYSIS	2 - 3
STATEMENTS OF NET ASSETS	4
STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS	5
STATEMENTS OF CASH FLOWS	6
NOTES TO THE FINANCIAL STATEMENTS	7 - 12
SUPPLEMENTAL INFORMATION	13



816 N Washington
Junction City, KS 66441
(785) 238-5166
Fax (785) 238-6830

529 Humboldt, Suite 1
Manhattan, KS 66502
(785) 537-9700
Fax (785) 537-3734

505 NW 3rd, Suite 1
Abilene, KS 67410
(785) 263-2171
Fax (785) 263-3340

www.pgh-cpa.com

MEMBERS:
American Institute of
Certified Public Accountants

Kansas Society of Certified
Public Accountants



Pottberg, Gassman & Hoffman, Chartered

INDEPENDENT AUDITORS' REPORT

Board of Directors
Ottawa County, Kansas
Rural Water District No. 2
Salina, Kansas 67402

We have audited the financial statements of Ottawa County Rural Water District No. 2, as of and for the years ended December 31, 2011 and 2010, as listed in the table of contents. These financial statements are the responsibility of the District's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the *Kansas Municipal Audit Guide*. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements present fairly, in all material respects, the financial position of Ottawa County Rural Water District No. 2, as of December 31, 2011 and 2010 and the results of operations and cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis on pages 2-3 and the budget report on page 13 are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted by the United States of America. We have applied certain limited procedures, which consisted primarily of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However we did not audit the information and express no opinion on it.

Pottberg, Gassman & Hoffman, Chartered

POTTBERG, GASSMAN & HOFFMAN, CHARTERED

Manhattan, Kansas
May 3, 2012

OTTAWA COUNTY RURAL WATER DISTRICT NO. 2

MANAGEMENT'S DISCUSSION AND ANALYSIS

Within this section of the Ottawa County Rural Water District No. 2's annual financial report, the District's management provides narrative discussion and analysis of the financial activities of the District for the year ended December 31, 2011. The District's financial performance is discussed and analyzed within the context of the accompanying financial statements and disclosures following this section.

In 2011, the district added six (6) units and lost five (5) due to customers choosing to terminate their water service, making a total of 859 units at year end. In 2011 the annual usage was 71,079,000 gallons of water, which showed an annual loss of 7.91%. Since we are a customer read district, the Board of directors has implemented a policy that a staff member will read all the meters once a year and whenever necessary, to help maintain a reasonable yearly percentage loss. The district continually communicates with customers to keep the accounts receivable to a minimum.

The Business Manager prepared the 2011 annual budget, as required by the BYLAWS of the District (see Article 8, Powers and Duties of Directors. Paragraph G). After preparing the annual budget for 2011, the water district was not in compliance with the bond covenants so the rates for water had to be increased. Effective, July 1, 2011 the water rates increased from \$3.00 per 1,000 to \$3.50 per 1,000.

To have funds available for the new well field and the water line that was needed to deliver water to the water tower on Ohio Street, the minimum charge to each patron had to be increased. The water District can use the remainder of the 2004 Revenue Bonds money that was issued for the well field at Sullivan's, seven miles of line extension on Simpson Road and the new chlorination building on Ohio Street. This amount is approximately \$490,631.17. The remainder of the estimated cost for the new well field and delivering water to the water tower is approximately \$922,000. The Engineer stated that it would cost each patron \$11.00 per month to pay for the new improvements, but by using the remainder of the 2004 Revenue Bonds it would cost each patron \$8.00 per month. The minimum charge would increase from \$27.00 per month to \$35.00 per month. This improvement fee became effective July 1, 2011.

The Water District did not rank high enough to receive a loan from Kansas Department of Health and Environment. The District would now have to apply for a loan with Kansas Rural Water Finance Authority. The water district board contacted Rose Mary Saunders with Ransom Financial to proceed with the KRWFA and apply for the 20 year Bond.

On October 13, 2011 Ms. Jane Moorman met the Board of Directors of Ottawa County RWD No. 2, along with the District's attorney Gary Hanson. The purpose of the meeting was to talk about some changes Ms. Moorman requested before signing the Agreement and easements to develop additional wells on her property. The amendment to the agreement was signed by Ms. Moorman and Kenneth Sly, Chairman. The permanent easement was signed by Ms. Moorman and Kenneth Sly, district Chairman and was recorded in the Minneapolis County Register of Deeds office. The amendment to the agreement, also provided for payments in four (4) equal annual installments, beginning with the year in which closing of the purchase of such easements occurs. The first payment is due January, 2012.

OTTAWA COUNTY RURAL WATER DISTRICT NO. 2

MANAGEMENT'S DISCUSSION AND ANALYSIS, CONTINUED

A contract was awarded to Chris Cox of Schwab-Eaton for the development of the new well field.

Mr. Ralph Luther submitted a proposed building plat on the quarter section immediately North of the well field and in our wellhead protection area. Three monitoring wells were drilled on the south edge of the property to evaluate the contamination threat to the district's well field. The contamination threat was there, so the district would have to drill 4 more monitoring wells on the North half of the quarter section to obtain more data. Mr. Luther indicated he would only develop the North half of the property, which would be okay with the district. No further information is available.

The new 200,000 gallon water tower on Country Club Road was constructed and placed in use by the end of the 2010 year. The inspection and final payment was completed in 2011.

The GPS mapping is being completed by Kansas Rural Water Association. It was to be finished in 2011 but some of the locates were lost and KRWA is redoing them at their expense.

All the substantial interest statements were completed and returned to the district.

The water district has an emergency disaster plan and a conservation plan in effect.

Since there are four employees and one contract worker of the district that are related, all their invoices and requests for reimbursement statements will be reviewed and signed by one of the Board members. Also, in the event a monthly meeting is not held, the bank account check register of the district will be presented to the Board of Directors for approval. This will show all invoices and payroll that was paid and all monies deposited. Each month the reconciliation of the bank accounts and bank statements will be reviewed and signed by the Chairman of the District.

In the event the district does not have a meeting that month, the following month the Board reviews the check register in which the statements were paid and signed by the Chairman and/or Treasurer and/or Norma Griffin. The checks have two signatures as required.

Should you have any questions concerning this report or any other water district matter, feel free to call 785.823.2093.

OTTAWA COUNTY RURAL WATER DISTRICT NO. 2
STATEMENTS OF NET ASSETS
DECEMBER 31,

ASSETS	<u>2011</u>	<u>2010</u>
Current Assets		
Cash in Bank	\$ 634,162	\$ 645,977
Accounts Receivable - Net	10,507	6,721
Inventory	16,450	17,846
Total Current Assets	<u>661,119</u>	<u>670,544</u>
Noncurrent Assets		
Construction Work in Progress	227,931	94,585
Capital Assets		
Engineering Costs	149,699	149,396
Office Equipment	26,699	25,247
Water Transmission and Distribution System	4,165,663	4,141,983
Water Wells and Easements	223,773	168,435
New Well Project	28,587	28,587
Accumulated Depreciation	<u>(1,972,135)</u>	<u>(1,855,477)</u>
Total Capital Assets	2,850,217	2,752,756
Bond Issuance & Discount Costs - 2001 (net of accumulated amortization of \$36,207 and \$32,888)	-	3,319
Bond Issuance Costs - 2004 (net of accumulated amortization of \$6,579 and \$5,672)	11,571	12,478
Bond Issuance Costs - 2009 (net of accumulated amortization of \$1,741 and \$905)	14,971	15,807
2004 Bond Proceeds	494,444	490,116
Certificate of Deposit - 2001 Bond Reserve	-	261,415
Certificate of Deposit - 2004 Bond Reserve	167,416	97,530
Certificate of Deposit - 2009 Bond Reserve	135,003	80,545
Certificates of Deposit - Easement Reserve	38,581	-
2009 Bond Proceeds	294,621	322,866
Total Noncurrent Assets	<u>4,006,824</u>	<u>4,036,832</u>
TOTAL ASSETS	<u>\$ 4,667,943</u>	<u>\$ 4,707,376</u>
LIABILITIES AND NET ASSETS		
Current Liabilities		
Accounts Payable	\$ 89,750	\$ 72,203
Accrued Interest Payable	17,733	20,017
Payroll Liabilities	1,559	1,719
Deferred Revenue	34,491	69,567
Bonds Payable - Current Portion	80,000	215,000
Easements Payable - Current Portion	12,850	-
Total Current Liabilities	<u>236,383</u>	<u>378,506</u>
Noncurrent Liabilities		
Bonds Payable - 2001 Bond Issue (less current portion of \$0 and \$215,000)	-	-
Bonds Payable - 2004 Bond Issue (less current portion of \$50,000 and \$0)	730,000	780,000
Discount on 2004 Bonds (net of accumulated amortization of \$5,372 and \$4,631)	(9,448)	(10,189)
Bonds Payable - 2009 Bond Issue (less current portion of \$30,000 and \$0)	855,000	885,000
Discount on 2009 Bond (net of accumulated amortization of \$1,613 and \$839)	(13,874)	(14,648)
Easement Payable (less current portion of \$12,850)	38,550	-
Total Noncurrent Liabilities	<u>1,600,228</u>	<u>1,640,163</u>
Total Liabilities	<u>1,836,611</u>	<u>2,018,669</u>
Net Assets		
Invested in Capital Assets, net of related debt	1,157,139	897,593
Restricted 2001 Bond Reserve	-	148,500
Restricted 2004 Bond Reserve	78,000	78,000
Restricted 2009 Bond Reserve	78,563	78,563
Unrestricted	1,517,630	1,486,051
Total Net Assets	<u>2,831,332</u>	<u>2,688,707</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 4,667,943</u>	<u>\$ 4,707,376</u>

The notes to the financial statements are an integral part of these statements.

OTTAWA COUNTY RURAL WATER DISTRICT NO. 2
STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
FOR THE YEARS ENDED DECEMBER 31,

	<u>2011</u>	<u>2010</u>
OPERATING REVENUES		
Water Sales	\$ 547,625	\$ 458,749
OPERATING EXPENSES		
Accounting Fees	6,105	5,890
Attorney Fees	1,195	1,815
Chlorine Fees	4,781	6,945
Clean Drinking Water Fees	2,078	1,744
Contract Wages	63,355	63,512
Dues and Subscriptions	3,296	653
Fees and Permits	165	25
Insurance	15,459	11,725
Internet Fee	624	624
IRA Contributions	2,172	2,065
Lab Fees	-	3,445
Mileage	23,804	18,455
Miscellaneous	2,402	2,568
Office Supplies Expense	4,623	5,953
Payroll Taxes	6,118	5,911
Power	25,199	24,666
Professional Fees	31,677	-
Repairs and Maintenance	11,914	11,338
Salaries and Wages	79,971	77,269
Supplies Expense	8,513	6,930
Telephone	4,705	7,009
Water Protection Fees	2,217	1,861
TOTAL OPERATING EXPENSES	<u>300,373</u>	<u>260,403</u>
INCOME FROM OPERATIONS BEFORE		
AMORTIZATION AND DEPRECIATION	247,252	198,346
Amortization	(6,578)	(6,879)
Depreciation	(116,657)	(103,525)
OPERATING INCOME (LOSS)	<u>124,017</u>	<u>87,942</u>
NON-OPERATING REVENUES AND EXPENSES		
Interest Income	24,466	35,012
Other Income	37,357	5,600
Interest Expense	(73,215)	(90,667)
TOTAL NON-OPERATING REVENUES (EXPENSES)	<u>(11,392)</u>	<u>50,055</u>
INCOME (LOSS) BEFORE CONTRIBUTIONS	112,625	37,887
Capital Contributions	30,000	20,000
CHANGE IN NET ASSETS	<u>142,625</u>	<u>57,887</u>
NET ASSETS, BEGINNING	2,688,707	2,630,820
NET ASSETS, ENDING	<u><u>\$ 2,831,332</u></u>	<u><u>\$ 2,688,707</u></u>

The notes to the financial statements are an integral part of these statements.

OTTAWA COUNTY RURAL WATER DISTRICT NO. 2
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31,

	<u>2011</u>	<u>2010</u>
CASH FLOWS FROM OPERATING ACTIVITIES:		
Cash Received from Customers	\$ 508,763	\$ 463,228
Cash Payments to Suppliers for Goods and Services	(108,384)	(99,706)
Cash Payments to Employees and Professional Contractors for Services	(173,206)	(151,248)
Net Cash Provided (Used) by Operating Activities	<u>227,173</u>	<u>212,274</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:		
Acquisition and Construction of Capital Assets	(214,119)	(677,900)
Principal Paid on Bonds	(215,000)	(165,000)
Principal Paid on Easement	51,400	-
Interest Paid on Bonds	(75,499)	(83,537)
Proceeds from Bond Issue	23,917	449,398
Bond Reserve Decrease (Increase)	137,071	(11,862)
Easement Reserve Decrease (Increase)	(38,581)	-
Other Capital Activities	37,357	5,600
Capital Contributions	30,000	20,000
Net Cash Provided (Used) by Capital and Related Financing Activities	<u>(263,454)</u>	<u>(463,301)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Investment Income	24,466	35,012
Net Cash Provided (Used) by Investing Activities	<u>24,466</u>	<u>35,012</u>
Net Increase (Decrease) in Cash and Cash Equivalents	(11,815)	(216,015)
Cash and Cash Equivalents at January 1	645,977	861,992
Cash and Cash Equivalents at December 31	<u>\$ 634,162</u>	<u>\$ 645,977</u>
Reconciliation of Operating Income to Net Cash Provided by Operating Activities		
Income from Operations	\$ 247,252	\$ 198,346
Changes in Receivables	(3,786)	(573)
Changes in Inventory	1,396	4,235
Changes in Payables less Capitalized Expense	17,387	4,381
Changes in Deferred Revenue	35,076	5,885
Net Cash Provided by Operating Activities	<u>\$ 227,173</u>	<u>\$ 212,274</u>

The notes to the financial statements are an integral part of these statements.

**OTTAWA COUNTY RURAL WATER DISTRICT NO. 2
SALINA, KANSAS**

NOTES TO THE FINANCIAL STATEMENTS

NOTE 1 - ORGANIZATION DESCRIPTION AND ACCOUNTING POLICIES

The Rural Water District No. 2, Ottawa County, Kansas (District), was declared incorporated as a municipal Corporation by the Board of Commissioners of Ottawa County, Kansas. The board of directors for the district adopted bylaws at a meeting of the landowners of the district on June 11, 1979.

Measurement Focus, Basis of Accounting, and Financial Statement Presentation

The water district is a governmental organization operated as a business (proprietary) type entity. It is accounted for using the "economic resources" measurement focus and the accrual basis of accounting, in conformity with accounting principles generally accepted in the United States of America. All assets and liabilities are included on the Statements of Net Assets. The Statements of Revenues, Expenses and Changes in Net Assets presents increases (revenues) and decreases (expenses) in total assets, and revenues are recognized in the period in which they are earned while expenses are recognized in the period in which the liability is incurred.

Operating revenues are those that are generated from primary operations. All other revenues are reported as non-operating revenues. Operating expenses are those expenses that are essential to the primary operations. All other expenses are reported as non-operating expenses, such as installation fees and reimbursement for benefit units.

Statements of Cash Flows

For purposes of the statement of cash flows, the District considers all highly liquid investments including bank deposit accounts, money market accounts and certificates of deposit classified as current assets to be cash and cash equivalents. Certificates of deposit with maturities of longer than three months can still be used by the district to meet current liabilities if they wish to pay any applicable penalties.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect certain amounts and disclosures. Accordingly, actual results could differ from those estimates.

Capital Assets

Capital assets purchased or built are capitalized at cost. Depreciation is recorded based on the estimated useful life of each asset using the straight-line method. The District's policy is to capitalize all assets with a cost of \$500 or more and a useful life exceeding one year.

Inventory

Inventory is stated at cost and consists of pipe, valves, meters, and other items needed to repair water lines.

Noncurrent Assets

Noncurrent assets primarily include construction in process, capital assets, bond issuance and discount costs and reserves for bonds and easements. The amounts placed in the reserve often exceed the amount legally required to be restricted as they include interest earned and other monies designated by the board to be set aside to meet future obligations. The amounts legally required to be restricted are included in the bond and easement payable footnotes.

**OTTAWA COUNTY RURAL WATER DISTRICT NO. 2
SALINA, KANSAS**

NOTES TO THE FINANCIAL STATEMENTS

NOTE 2 – DEPOSITS AND INVESTMENTS

K.S.A. 9-1401 establishes the depositories which may be used by the District. The statute requires banks eligible to hold the District's funds have a main or branch bank in the county in which the District is located, or in an adjoining county if such institution has been designated as an official depository, and the banks provide an acceptable rate of return on funds. In addition, K.S.A. 9-1402 requires the banks to pledge securities for deposits in excess of FDIC coverage. The District has no other policies that would further limit interest rate risk.

K.S.A. 12-1675 limits the District's investment of idle funds to time deposits, open accounts, and certificates of deposit with allowable financial institutions; U.S. government securities; temporary notes; no-fund warrants; repurchase agreements; and the Kansas Municipal Investment Pool. The District has no investment policy that would further limit its investment choices.

Concentration of credit risk. State statutes place no limit on the amount the District may invest in any one issuer as long as the investments are adequately secured under K.S.A. 9-1402 and 9-1405.

Custodial credit risk – deposits. Custodial credit risk is the risk that in the event of a bank failure, the District's deposits may not be returned to it. State statutes require the District's deposits in financial institutions to be entirely covered by federal depository insurance or by collateral held under a joint custody receipt issued by a bank within the State of Kansas, the Federal Reserve Bank of Kansas City, or the Federal Home Loan Bank of Topeka, except during designated "peak periods" when required coverage is 50%. The District has no designated "peak periods." All deposits were legally secured at December 31, 2011 and 2010.

At December 31, 2011 the District's carrying amount of deposits was \$1,764,227 and the bank balance was \$1,765,948. The bank balance was held by 5 banks with all holding more than 5% of the total bank balance, resulting in a concentration of credit risk. Of the bank balance, \$887,215 was covered by federal depository insurance and \$339,668 was collateralized with securities held by the pledging financial institutions' agents in the District's name and \$539,065 was collateralized with securities held by the pledging financial institutions' agents in a third party name.

The following is a comparison of depository security with balances on deposit with the District's designated depositories:

	Demand Deposits on <u>12/31/2011</u>	Time Deposits on <u>12/31/2011</u>	FDIC <u>Coverage</u>	Pledged <u>Securities</u>	Unsecured <u>Deposits</u>
Bennington State Bank	\$83,388	\$82,578	\$165,966	-	-
Bank of Tescott	-	589,668	250,000	\$339,668	-
Great Plains FCU	1,923	118,687	120,610	-	-
United Bank & Trust	789,065	-	250,000	539,065	-
First Bank Kansas	-	100,639	100,639	-	-

NOTE 3 – ACCOUNTS RECEIVABLE

Accounts receivable are customer water bills that have been invoiced but remain unpaid. The balance is shown net of the allowance for doubtful accounts. Using past payment history and the aging report, the allowance as of December 31, 2011 and 2010 has been determined to be zero.

**OTTAWA COUNTY RURAL WATER DISTRICT NO. 2
SALINA, KANSAS**

NOTES TO THE FINANCIAL STATEMENTS

NOTE 4 – CAPITAL ASSETS

During 2004 the District's infrastructure assets were estimated using expenditures of prior years and are stated retrospectively. The water distribution system, wells and related easements and engineering costs are being depreciated over 40 years.

<u>Balance</u> <u>01-01-11</u>	<u>Accumulated</u> <u>Depreciation</u>	<u>Purchases</u>	<u>Disposals</u>	<u>Depreciation</u>	<u>Balance</u> <u>12-31-11</u>
<u>\$4,513,648</u>	<u>(\$1,855,477)</u>	<u>\$80,772</u>	<u>(\$ 0)</u>	<u>(\$116,657)</u>	<u>\$2,622,286</u>

NOTE 5 – DEFERRED REVENUE

Multiple District customers have paid in advance for water usage. These amounts have not been earned and would be refundable if water usage discontinues. The balance of these customer credits was \$34,491 at December 31, 2011 and \$69,567 at December 31, 2010.

NOTE 6 – BONDS PAYABLE

On December 1, 2001, the district issued \$1,485,000 in Kansas Rural Water Finance Authority Revenue Bonds, Series B, 2001 with effective interest rates ranging from 2.50% to 4.75% to refund their Kansas Rural Water Finance Authority Revenue bonds, Series C, 1996 in the amount of \$1,455,000. Interest payments are due semi-annually on October 1 and April 1. Principal payments are due on April 1 maturing in 2011.

On August 1, 2004, the district issued \$780,000 in Kansas Rural Water Finance Authority Revenue Bonds, Series C, 2004 with effective interest rates ranging from 3.85% to 5.00%. The purpose of the bond issue was to construct a second main under I-70 (completed in 2005), develop a new well (completed in 2007) and construct a new chlorination building as well as remodel the existing chlorination building. Work has not yet begun on the chlorination buildings. Interest payments are due semi-annually on April 1 and October 1. Principal payments are due starting on October 1, 2012 and maturing in 2024.

On December 1, 2009, the district issued \$885,000 in Kansas Rural Water Finance Authority Revenue Bonds, Series B, 2009 with effective interest rates ranging from 1.75% to 4.75%. The purpose of the bond issue is to purchase a water tower. Interest payments are due semi-annually on June 1 and December 1. Principal payments are due starting on December 1, 2012 and maturing in 2029.

2001 Bonds Payable Information:

Issuance costs of \$23,912 were paid at the time this revenue bond was issued in 2001. This cost was capitalized and amortized over the life of the revenue bonds using the straight-line method. Amortization for 2011 and 2010 was \$2,192 and \$2,391 respectively. The bonds were issued at a discount of \$12,295 which was amortized over the life of the bonds using the straight-line method. Amortization for 2011 and 2010 was \$1,127 and \$1,230 respectively. A bond reserve account of \$148,500 was required to be maintained. As this bond was paid-off in 2011, the reserve amounts were moved into the operating funds of the District.

**OTTAWA COUNTY RURAL WATER DISTRICT NO. 2
SALINA, KANSAS**

NOTES TO THE FINANCIAL STATEMENTS

NOTE 6 – BONDS PAYABLE (CONTINUED)

2004 Bonds Payable Information:

<u>Year</u>	<u>Principal</u>	<u>Interest</u>	<u>Total Payment</u>
2012	\$50,000	35,480	85,480
2013	50,000	33,555	83,555
2014	50,000	31,555	81,555
2015	50,000	29,505	79,505
2016	50,000	27,405	77,405
2017-2021	300,000	100,595	400,595
2022-2024	<u>230,000</u>	<u>23,175</u>	<u>253,175</u>
Totals	<u>\$780,000</u>	<u>\$281,270</u>	<u>\$1,061,270</u>

Issuance costs of \$18,150 were paid at the time this revenue bond was issued. The cost was capitalized and is being amortized over the life of the revenue bonds, using the straight-line method. Amortization for 2011 and 2010 was \$907 each year. The bonds were issued at a discount of \$14,820 which is amortized over the life of the bonds using the straight-line method. Amortization for 2011 and 2011 was \$741 each year. A bond reserve account of \$78,000 is required to be maintained. \$100,639 is segregated as a Certificate of Deposit at First Bank Kansas and \$66,777 is in a Certificate of Deposit at the Bank of Tescott.

2009 Bonds Payable Information:

<u>Year</u>	<u>Principal</u>	<u>Interest</u>	<u>Total Payment</u>
2012	\$30,000	35,450	65,450
2013	35,000	34,850	69,850
2014	35,000	34,045	69,045
2015	35,000	33,135	68,135
2016	40,000	32,085	72,085
2017-2021	220,000	137,965	357,965
2022-2026	280,000	87,615	367,615
2027-2029	<u>210,000</u>	<u>20,425</u>	<u>230,425</u>
Totals	<u>\$885,000</u>	<u>\$415,570</u>	<u>\$1,300,570</u>

Issuance costs of \$16,712 were paid at the time this revenue bond was issued. The cost was capitalized and is being amortized over the life of the revenue bonds, using the straight-line method. Amortization for 2011 and 2010 was \$836. The bonds were issued at a discount of \$15,487 which is amortized over the life of the bonds using the straight-line method. Amortization for 2011 and was \$775 and for 2010 was \$774. A bond reserve account of \$78,563 is required to be maintained. \$82,578 is segregated as a Certificate of Deposit at Bennington State Bank and \$52,425 is in a certificate of Deposit at the Bank of Tescott.

NOTE 7 – EASEMENT PAYABLE

In March 2010, the District approved the payment of an easement in the amount of \$51,400 to establish a water source for the District. The payments are to be paid in four equal amounts of \$12,850 starting in January 2012. \$38,581 is segregated as three Certificates of Deposit at Great Plains Federal Credit Union.

**OTTAWA COUNTY RURAL WATER DISTRICT NO. 2
SALINA, KANSAS**

NOTES TO THE FINANCIAL STATEMENTS

NOTE 8 – DEBT SERVICE RATIO

The bond issue covenants require the District to maintain a debt service ratio of at least 1.25.

Debt Service Ratio Calculation for the year ending:

	<u>December 31, 2011</u>	<u>December 31, 2010</u>
Change in Net Assets	\$142,625	\$57,887
Interest Expense	73,215	90,667
Amortization & Depreciation	123,235	110,404
Less Capital Contributions	<u>(30,000)</u>	<u>(20,000)</u>
Total Revenue Available for Debt Service	<u>\$309,075</u>	<u>\$238,958</u>
Debt Service Payments	\$290,499	\$248,537
Debt Service Ratio	<u>1.06</u>	<u>1.04</u>

As described in NOTES 16 and 17, the District is in violation of their bond covenants. Steps have been taken to increase the debt service ratio in 2012. The debt service payments due in 2012 total \$150,930. The new water rates will be in effect for the entire year rather than six months as in 2011. The debt service ration for 2012 is estimated to be 2.05.

NOTE 9 – LONG TERM DEBT SCHEDULE

The following schedule shows the changes in long-term debt and related maturities.

<u>Revenue Bonds</u>	<u>Date Issued</u>	<u>Original Amount</u>	<u>Outstanding 01-01-11</u>	<u>Principal Payments</u>	<u>Outstanding 12-31-11</u>	<u>Interest Paid In 2011</u>
2001	12-01-01	\$1,485,000	\$215,000	\$215,000	\$ -	\$4,569
2004	08-01-04	780,000	780,000	-	780,000	35,480
2009	12-01-09	<u>885,000</u>	<u>885,000</u>	<u>-</u>	<u>\$885,000</u>	<u>35,450</u>
Total Indebtedness		<u>\$3,150,000</u>	<u>\$1,880,000</u>	<u>\$215,000</u>	<u>\$1,665,000</u>	<u>\$75,499</u>

NOTE 10 – BUDGETS AND BUDGETARY ACCOUNTING

The District is not required to adopt a legal budget; therefore, no budgetary comparison is prepared as a financial statement. The Board approves a budget each year, which is used by management to internally monitor the District's expenditures and is presented as supplementary information.

NOTE 11 - RETIREMENT PLAN

The district provides a Simple IRA for the full time employees as retirement compensation. The District contributes 3% of the employees' wages to these IRAs. In 2011, the District contributed \$2,172 and in 2010, \$2,065 to the retirement plan. The IRAs are with American Funds.

NOTE 12 - COMPENSATED ABSENCES POLICY

The District provides vacation leave for the Business Manager. There is no written policy for the carry forward of unused time nor for the payment of unused time at termination or retirement. Therefore no accrual has been made.

NOTE 13 - LITIGATION

There were no legal actions involving the District as of December 31, 2011.

**OTTAWA COUNTY RURAL WATER DISTRICT NO. 2
SALINA, KANSAS**

NOTES TO THE FINANCIAL STATEMENTS

NOTE 14 – RELATED PARTIES

All the members of the board of directors are water district customers. The only material transactions were water purchases consummated on the same terms as all other water customers.

NOTE 15 – RISK MANAGEMENT

Ottawa County Rural Water District No. 2 is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. To insure against risk of these types of losses, the District has purchased commercial insurance coverage from EMC Companies through Anderson Peck Agency Inc. in Topeka, Kansas. Settled claims resulting from these risks have not exceeded commercial coverage.

NOTE 16 – CONTINGENCIES

As detailed in NOTE 8 the District is in violation of a bond covenant requiring a debt service ratio of 1.25. In the process of adding new wells financed by the bonds the District has used many man hours of the their own staff. Their recordkeeping did not provide the ability to capitalize the corresponding wage and benefit costs. As a result the debt service ratio decreased due to these costs that were not capitalized. The District had sufficient cash available to make the debt service payments.

In order to assist in meeting the required debt service ratio, the District implemented a new rate schedule effective as of July 1, 2011. The new rate schedule is \$3.50 per 1,000 gallons with a minimum rate set at \$35.00 per month. The previous rate schedule was \$3.00 per 1,000 gallons with a minimum rate of \$27.00 per month. With the assistance of Ransom Financial, it was estimated this rate increase would generate an additional \$58,000 of revenue during 2011.

During 2011, the 2001 Bond issue will be paid in full and subsequent years debt service payments will be significantly reduced. The District does not feel that debt service ratio violation will cause the bonds to be called or reduce their credit standing in any way.

NOTE 17 – SUBSEQUENT EVENTS

Management has performed an analysis of the activities and transactions subsequent to December 31, 2011 to determine the need for any adjustments to and/or disclosures within the audited financial statements. Management has performed their analysis through May 3, 2012, which is the date at which the financial statements were available to be issued.

OTTAWA COUNTY RURAL WATER DISTRICT NO. 2
BUDGET REPORT - CASH BASIS
FOR THE YEAR ENDED DECEMBER 31, 2011

	<u>Budget</u>	<u>Actual</u>	Variance Over (Under)
OPERATING REVENUES			
Water Revenues	<u>\$ 487,000</u>	<u>\$ 508,763</u>	<u>\$ 21,763</u>
OPERATING EXPENSES			
Chlorine Fee	7,000	4,781	(2,219)
Clean Drinking Water Fee	1,800	2,078	278
Contract Wages	66,000	63,355	(2,645)
Dues and Subscriptions	750	3,296	2,546
Fees and Permits	500	165	(335)
Insurance	11,950	15,459	3,509
Internet Fee	624	624	-
IRA Contributions	2,200	2,172	(28)
Lab Fees	3,200	-	(3,200)
Mileage	22,000	23,804	1,804
Miscellaneous	12,800	2,402	(10,398)
Office Supplies Expense	5,000	4,623	(377)
Payroll Taxes	6,700	6,278	(422)
Power	25,000	25,199	199
Professional Fees	10,000	38,977	28,977
Repairs and Maintenance	14,200	(7,029)	(21,229)
Salaries & Wages	78,000	79,971	1,971
Supplies Expense	13,000	8,513	(4,487)
Telephone	6,200	4,705	(1,495)
Water Protection Fee	1,920	2,217	297
TOTAL OPERATING EXPENDITURES	<u>288,844</u>	<u>281,590</u>	<u>(7,254)</u>
DEBT RETIREMENT:			
Bond Principal Paid	215,000	215,000	-
Bond Interest	75,488	75,499	11
Easement Principal Paid	-	(51,400)	(51,400)
TOTAL EXPENDITURES	<u>579,332</u>	<u>520,689</u>	<u>(58,643)</u>
OTHER INCOME (EXPENSES)			
New Benefit Units	25,000	30,000	5,000
Interest Income	32,000	24,466	(7,534)
Other Income and Expense	58,048	159,764	101,716
Capital Improvements	-	(214,119)	(214,119)
TOTAL OTHER INCOME (EXPENSE)	<u>115,048</u>	<u>111</u>	<u>114,937</u>
INCREASE (DECREASE) IN CASH	<u>\$ 22,716</u>	<u>\$ (11,815)</u>	<u>\$ (34,531)</u>